EASTERN ECONOMIST PAMPHLETS
General Editor: E. P. W da COSTA

DEVALUATION

FORTY QUESTIONS AND ANSWERS

SECOND EDITION

(Revised and Enlarged)

GENERAL EDITOR'S PREFACE TO THE SECOND EDITION

There has been continuous demand for a reprinting of " Devaluation—Forty Questions and Answers"—the first edition of which was sold out within a month. It was indicated in the preface to the first edition that a fuller pamphlet would be issued by 'The Eastern Economist' when the long-term currents could be better seen. A month is too short a period in which to redeem this promise; the long-term currents are still uncertain and, in one respect in particular, Indo-Pakistan trade, the situation is more uncertain than it was two months ago. Nevertheless there have been important developments which require notice; the most important of these are the promulgation of a minimum price for jute in Pakistan and the creation of the East Bengal Jute Board; the raising of the price of oil and of wheat, the latter still in the process of controversy with Australia demanding higher prices and Britain and India resisting; the changes in the pattern of India's trade as a result of influences arising from devaluation are also more visible the demand for our textiles in export markets, for example, having steadily increased. These facts alone would require some restatement of the answers given in the pamphlet and, while maintaining its original limited purpose, the pamphlet has in this edition been considerably revised and enlarged.

It is proposed within three months to follow this pamphlet with one on 'Devaluation and India's Foreign Trade,' being Part II of the series of which Part I,

'India's Foreign Trade (Before Devaluation),' written by Mr. L. K. Jha, was issued in November. That pamphlet will deal more fully with the impact of devaluation on India's economic life and, will go some way to an assessment of long-period factors which the present work does little to assess.

1st December 1949.

GENERAL EDITOR'S PREFACE TO THE FIRST EDITION

What is Devaluation ? In the early hours of the morning of Monday, the 19th September, there were thousands of people who apparently had never heard the word that wished to know eagerly what had happened. The papers said that a Pound which had been 4.03 dollars on Sunday was only 2.80 dollars on Monday; and the Indian rupee was down from 30.225 cents to 21 cents. In the course of three days, twenty-four currencies had devalued meaning that they had reduced their rates of exchange with the dollar. What was the meaning of this general post-chaise in the world's currencies ; what was its cause and what are its short period effects ; above all, how is India affected and how are various groups in India affected ? Are prices here going to rise ; if so, which prices and how much? What is to happen to our trade with Pakistan which has not devalued; and why should India's decision have been different from Pakistan's? All these questions have come at once and they demand immediate answers. This is not only because the questioners are impatient ; it is because the problems of trade which devaluation raises refuse absolutely to wait.

This explains the limited purpose of the present phlet. There is no time to answer all the questions that devaluation raises at length ; nor, indeed, is a long and erudite answer required. The need at the present time is for straight answers to straight questions. By and large, those answers have not yet been clearly given. The present attempt in question and answer form is to fill this gap.

The answers show that this is by far the easiest gap to fill. There are now gaps everywhere gaps in our balance of payments, gaps in the real purchasing power of our rupee in the currencies which have not devalued. There is a gap in physical supplies, of raw jute, of raw cotton, of capital goods and all those supplies from dollar areas to which we have grown accustomed in the profligacy of our import policy under O.G.L. XI. But it is a mistake to suppose that all these hardships are the outcome of devaluation by itself. The virtual suspension of our old import policy was decided on a fortnight before devaluation came and although O.G.L. XVI still advertises the fact that we have open general licences, we really have no very significant unlicensed and uncontrolled imports worth the name When correctives to the gap due to devaluation are devised, our imports will need to be further cut. But for the moment the main cut in our imports which has caused significant price rises even in sterling goods was not the outcome of devaluation. One of the most important answers is that to the question how far price rises flow from devaluation and how far they were anterior to it, flowing simply from the closure of our balance of payments gap.

Devaluation will be known only by its fruit, possibly after some years. A verdict at the present time must be given because we need to deal with short period consequences now, and these consequences loom at present very large. This pamphlet deals with the future as far as it can be foreseen, but it is necessary to say that it cannot be seen very far. In other words, this little work is not intended to fulfil anything more than

an immediate need. When the long-term currents can be better seen, it is hoped to publish a fuller pamphlet which will review the situation with the larger outlook which comes from not being too close to the object viewed.

These questions and answers have been framed and answered by Mr. R. K. Seshadri, Assistant Editor of 'The Eastern Economist,' who has for many years specialised on problems of Indian finance. The answers as framed are Mr. Seshadri's own, but they also represent the views of 'The Eastern Economist' on all issues where an opinion has been advanced.

New Delhi,
1st October, 1949

Questions and Answers

1. How is the exchange value of a currency fixed?

1. The exchange value of a currency is generally related to its purchasing power—this is called the purchasing power parity—in relation to other currencies, and with reference to the suitability of the exchange rate for enabling the country to balance its trade accounts. The indices of wholesale prices and of the cost of living are used to arrive at the purchasing power parities, but the construction and weighting of index numbers of wholesale prices is not uniform, and, in a country like England, where there is believed to be a permanent tendency towards inflation resulting from the maintenance of social services at the existing scale, cost of living indices are misleading, as they hide the fact of high costs in industry.

In modern conditions only an empirical test is applied in practice, namely, whether any particular exchange rate is likely, if maintained, to lead to a fundamental disequilibrium in a country's external balance of payments. The International Monetary Fund has been convinced that for a number of countries in the world this is the case. In December 1946, when

September 1949, the quotation in New York was 4½ cents above the new parity rate. The narrow margin of this premium is *prima facie* indication that the measure of the devaluation was approximately correct.

The fact that the £ Sterling has been quoting recently in the New York free Sterling market at rates varying from $ 2.59 to $ 2.62, and that £ 1 million Sterling a week has been offered and purchased at this rate, confirms the view that the rate fixed was not too low.

4. Will devaluation, coming at this time, help the British economy significantly?

1. Devaluation is not a permanent or cure remedy. It artificially lowers external British prices at present. The immediate result is good but devaluation can be successful only if the reduction in prices advertised can be permanent. British prices will have to be brought down permanently. This means that wage increases, such as the current claim of the engineering workers for a £ 100 million increase in wages, should not be granted. Hours of work will temporarily have to be increased; in 1948 they were on the average only 45.3 per week. Productivity per worker will have to be increased by re-organisation. In one British textile mill, productivity was increased in 1948 by 40 per cent by rationalisation. Though the same spectacular results cannot be uniformly attained, there is considerable scope for improving the methods of production. As the first result of devaluation is likely to be an increase in exports, there will be a reduc

tion in supplies for the home market; and either by rationing or by subsidies within the present volume of Government expenditure, a rise in prices will have to be prevented. Out of £ 300 millions worth of goods and services which Britain imports from the dollar areas at present, some £ 139 millions represents the cost of raw materials (excluding freight). The increased cost of these raw materials will have to be absorbed by increased productivity.

The greatest need, however, is to study the American market. At an average level of £ 3.75 millions per month—if it can be assumed—British exports to the United States will amount, at the revised parity of the £ sterling to £ 126 millions per annum. This amounts to approximately one-half of one per cent of the current level of the United States' national income. In other words, the United States' demand for British goods not being great, prices though important are by no means the only obstacle to be overcome. It is clear that devaluation will not help in the long run, if it is not accompanied by detailed and specific studies of the American market for British exports. This is the task of the Dollar Exports Board which Mr. Harold Wilson, President of the British Board of Trade, has recently set up.

The target for exports for 1950 was £ 185 millions destined for the dollar areas; this was the Dollar Export Board's figure before the Devaluation of the £; since devaluation it has to be stepped up to approximately £ 254 millions, in order to obtain the same amount in dollars.

The figures for the first full month after devaluation indicate that exports to the United States totalled £ 5.6 millions and exports to Canada £ 6.4 millions. Although in terms of sterling values these indicate improvements of the order of 37 per cent and 21 per cent respectively over the previous month, there is no improvement in terms of dollars. It is too early, however, to judge from the results of a single month.

5. Will devaluation drive up prices in Great Britain? If so, by how much?

5. The cost of a loaf of bread has already been fixed in England at 5½d one penny higher than the last prevailing rate, but half a penny less than the rate expected. It has been calculated that the cost of the items from the dollar areas entering into the British cost of living index is 16 per cent. Mathematically, therefore, on a forty-four per cent increase in the price of dollar imports, the cost of living can theoretically go up by seven per cent. This, however, is the increase on account of the increased cost of imports from the dollar areas only. The European hard currencies have also to be taken into account. Taking these and other circumstances into account, it will be surprising if the British cost of living does not rise, as a result of devaluation, by about ten per cent, although the British Chancellor of the Exchequer in a recent review promised that there will not be a rise by the end of the year, of more than 3d. in the £.

This is exclusive of the price of raw materials referred to above.

6. How does the devaluation of the £ affect the Sterling area ?

6. The sterling area was importing from the dollar areas in the year 1948, \$ 2,717 millions worth of goods. As a result of the meeting of the Commonwealth Finance Ministers in July 1949, it was agreed that the total imports would be restricted to a ceiling of approximately \$ 2,000 millions. For imports which cannot be financed within this ceiling, the sterling area is dependent on itself. The result of devaluation is that the countries of the sterling area will now have to purchase this \$ 2 billions worth of goods with approximately forty four per cent more money in their own currencies. If exports cannot be increased to this extent, and if on the assurance of such an increase in exports the ceilings for imports are not refixed by agreement at another conference of Commonwealth Finance Ministers, we will have to do without goods to a corresponding extent. This is the most important result.

A secondary result is that sterling area countries can now borrow from the International Monetary Fund. Hitherto, the Fund was refusing applications from the sterling area members, because according to the articles of agreement, the Fund is prevented from advancing money to countries which have not corrected a fundamental disequilibrium in their economies.

Another result is that 'hot' money will now return. Exchange control in the sterling area countries does not at present prevent absolutely the movement of funds—the transfers of current earnings on investment is for

example free. Apart from illicit holdings of foreign exchange which are negligible in relation to the total volume of transactions, fears or hopes of a coming devaluation always drive out money from the country. This may be illustrated as follows: According to non-official estimates made for the pre-war year 1938, the extent of United States investment in India was approximately $ 48.8 millions. The investments of joint-stock companies in India foreign - owned is unofficially estimated at present at Rs. 230 crores. The profit-earned on this investment or repatriation of this investment will pay, if it can be transferred to the United States, or to other hard currency countries and if more rupees can later be purchased with the dollars or hard currencies so obtained. The encouragement to this transfer and the consequent pressure on our
of payments will now disappear.

are the important results from a
point of view. From a short-term point of view, that part of the sterling releases earmarked by the sterling area countries for conversion into dollars, in consultation with the United Kingdom will now purchase less dollars. The total holdings of gold and dollars of the central reserves of the sterling area at the end of June, 1949, amounted to £ 406 millions. In view of the low level to which these reserves have fallen during the quarter-ended September, 1949, they are now reduced to £ 351 millions the releases of hard currency cannot be increased. The sterling releases intended to be converted into dollars will also buy

7. Is it possible to fix the value of the Indian Rupee at present?

7. With 1937 as the base, the Monetary Fund index of wholesale prices in India in June 1949 was 354, against 180 in the United States, 213 in the United Kingdom and about 185 in Canada.

The cost of living indices in the four countries during the same period were approximately 299,165,179 and 157.

These figures are a *prima facie* indication that there was justification for the rupee to move in step to the full extent of 30.5 per cent. The cost of a greater measure of devaluation would have been prohibitive. A smaller measure of devaluation than 30·5 per cent would have led to expectations of a further devaluation. In the other countries which have devalued in step, costs of the goods entering into export trade are appreciably smaller. It has been calculated, for example, that in 1948, the price of export goods was 131 per cent higher in Australia and 72 per cent higher in New Zealand than in 1937. In India, the same index based on 1937 has not been constructed, but fibres were 328 per cent higher than in the first half of 1939, and jute manufactures were 449 per cent dearer than they were in the same period. In view of these comparisons, it is likely that even if India had not devalued by 30.5 per cent to begin with, the pressure on her to do so would have been great.

8. Is there any legal compulsion for the Rupee to move in step with the £ ?

8. No. The Reserve Bank of India Act was amended in 1947 to remove the compulsory link with sterling.

9. If not, what are the overall advantages of moving in step ?

9. The British decision was taken primarily with reference to the British economy. Faced with this decision India had to decide whether her long-term interests would be served by moving in step with the sterling area or by staying put or by an independent decision, one of the considerations which weighed with the Government of India was the amount of current releases likely to be available from her blocked sterling. The total sterling releases to all countries from balances which were blocked in London, the No. 2 accounts as they are called, amounted to approximately £ 200 millions per annum. At the present rate, these releases in the case of India amount to £ 100 millions a year,— a basic rate of £ 50 plus an extra £ 50 to cover the cost of transition to the full rigour of the new import policy— and even if we assume that when the new import policy has come fully into operation, the rate of release will be slowed down, the additional parcels of foreign exchange available in future years, say 1950-51, will not be less tnan £ 50 millions a year. If we cut adrift from the present exchange ratio with the £ sterling, the goodwill which has made liberal releases possible recently will not endure,

especially because our imports from the dollar areas would in that event be larger than they would now be. With smaller parcels of release, we would also find that in the dollar area generally, these additional parcels of foreign exchange would buy less. This was a consideration which could not be ignored. In respect of our own trade, the volume of our transactions with sterling and soft currency areas is more than double the volume of our trade with the hard currency areas. For 1948-49, the figures were Rs. 592.07 crores in the one case and Rs. 262.13 crores in the other case. *Prima facie,* therefore, the balance of advantage was in favour of moving in step with the sterling countries. This consideration was reinforced by the fact that it is easier to expand our exports in the case of the sterling and soft currency countries than in the case of the hard currency countries. The result of non-devaluation or partial devaluation might easily have been that our efforts to increase our exports would have met with stiff resistance, that our imports from the non-hard currency areas would have cost substantially more, and that our monetary ceilings for imports from the dollar areas would have had to be fixed lower. In short, our stakes in the trade with the sterling and soft currency countries are very much greater.

10. How much will India have lost if she had not devalued along with the £ ?

10. Our imports from the dollar areas, that is to say, the United States and Dependencies, Canada and Newfoundland, and the American account countries

amount in value at present to about Rs. 100 crores per annum. At the rate of exchange which prevailed before the rupee was devalued, this would have been equivalent to 302.25 million dollars but now it will only be 210 million dollars. If we had not devalued, we would have retained the difference, namely, 92.25 million dollars (Rs. 30.04 crores approximately at the old parity). If we assume that exports to these dollar areas, after allowing for the fall which took place before devaluation are of the order of Rs. 90 crores at present,

and this seems to have been assumed at the Commonwealth Finance Ministers' Conference these Rs. 90 crores would have earned at the old parity 272 million dollars. Now they will earn only 189 million dollars. If we had decided not to devalue, we might have been saved the loss which is the difference between these two figures, namely, 83 million dollars. In respect of the sterling and soft currency areas also, there would have been an initial advantage. Our imports worth Rs. 341.47 crores from sterling and soft currency areas would have been cheaper by about 30.5 per cent and an outlay of about Rs. 341 crores on imports from the sterling area would have brought in 44 per cent more in real terms. Our exports to these areas would have brought in 44 per cent more of the foreign currencies. All this is a mathematical possibility. But in real life, these simple mathematical consequences would not have followed. The level of American imports would have been cut by reason of cuts in the releases of blocked sterling. The level of exports to the United States could not have been maintained in view of the cheaper prices being offered by countries which have devalued, in

markets where the bargaining power of the buyer has been considerably increased. The soft currency countries would have offset the decrease in the prices of their exports by differential export duties. Our exports, already vulnerable because of the price factor, would have been shut off by import licensing elsewhere. With so many influences working to offset the mathematical advantages of staying put, overseas buyers would have stopped buying, and would be exhausting stocks already built up, against an expected fall in the external value of the Rupee.

Devaluation has the merit that it did not start all this speculation about the future of our trade.

11. If India had not devalued along with the £, is it possible that Pakistan's decision would have been the same ?

11. Pakistan's total trade with countries other than India is approximately equal to her total trade with India. If India had not devalued, trade with India and the hard currency areas taken together would have been so important in relation to Pakistan's total trade that she would have been in favour of her staying put.

12. What would have been the consequences on the Indian price level of a decision not to devalue the Rupee ?

12. Assuming that the level of internal prices is primarily concerned with the level of our imports and

exports, there seems to be little doubt that, in the very short period, devaluation has accentuated inflationary conditions. This is partly because of the higher cost of dollar imports, but also because the increase in our adverse balance of payments, possibly of the order of Rs. 20 to Rs. 30 crores, leads to further restrictions of imports. At the same time any stimulus to exports, not offset by new internal production, will tend to push up internal prices. It is difficult to estimate these factors accurately either in the very short or very long period. But since the extravagantly liberal import policy of 1948-49 did not greatly depress internal prices, there is *prima facie* evidence that the restriction of imports both because of the new foreign exchange budget and devaluation will not be very inflationary ; the price level was going up slowly before devaluation : devaluation has accelerated this movement but it is unlikely of itself to push up wholesale prices by more than five per cent.

13. What is the cause of the rise in prices of oil and kerosene?

13. The f. o. b. prices of petroleum products and kerosene have gone up by 44 per cent consequent on devaluation. This means an increase of three annas per imperial gallon in the case of petroleum products ; retail prices of kerosene are expected to be maintained at old levels, in spite of a 44 per cent increase in f. o. b. cost, by an equivalent reduction in retail margins.

The increase in f. o. b. cost has been justified because America's dominance in the world's oil trade makes it reasonable for oil prices from Iran and the

rest of the Middle East to be fixed with reference to Gulf parity prices; the cost of transportation is also normally charged from the Gulf of Mexico to the port of destination, but this is not a rigid principle and actual cost of transportation has been charged instead by negotiated agreements. The oil companies have also contended that their re-equipment programme justifies the price increases, but they have recently been paying dividends of the order of 30 per cent, and there is room to split the advantage between producers and consumers, the oil companies being compensated only for the increased dollar cost of oil involved in reasonable programme for re-equipment.

The bulk of the oil imports into India, except for other lubricants, is from Iran, from production controlled by sterling oil companies in which His Majesty's Government has a predominant interest. It may be expected therefore that this matter will be raised by India at the next Conference of Commonwealth Financial Representatives.

14. What is the extra cost of dollar and hard currency imports as a result of re-fixation of the value of the Rupee ?

14. As already stated, our hard currency imports are now restricted to a ceiling of Rs. 100 crores. To purchase these same imports in physical quantity we would need to pay an extra Rs. 44 crores. Imports of some order would need to be cut unless our exports rise adequately.

15. What is the volume of foreign exchange lost as a result of the new parity?

15. In view of the hypothetical nature of the consequences which would have followed our decision not to devalue, the loss cannot be estimated in mathematical terms ; estimates as wide apart as Rs. 10 and Rs. 28 crores have been made. Much depends on the way our export trade behaves.

16. Was India justified in raising her prices to recoup herself for losses owing to higher prices charged in the sterling area ?

16. Yes. The price of sterling oil and wheat has ; up; differential prices have been quoted by sterling area producers to the United Kingdom and other countries e.g., the case of copra from Ceylon, there has been profiteering in the rice trade, the elasticity of our exports in the short-term is limited, and the likelihood of aid from the sterling areas, apart from sterling releases, is extremely limited. There is justification therefore for new prices settle at rates where they are e and cheap, but secure at the same time that no advantage which might accrue from the prices which the goods concerned can command, is lost. The actual decision regarding the remunerative level of prices will naturally differ from commodity to commodity, e.g., tea prices should fall but manganose prices can be maintained.

17. What extra payments will India have to make to the International Monetary Fund & the Bank?

17. According to the Final Acts of the Fund and the World Bank, a member whose currency is devalued is obligated to pay in its own currency, on demand from the institutions and within a reasonable period of time, an amount proportionate to the percentage by which its currency has depreciated in terms of gold. As on the 30th June, 1949, the International Monetary Fund held 156.308 crores of Indian rupees. The World Bank held Rs. 23.20 lakhs on the same date, and there was a promise to pay Rs. 23.58 crores at the then prevailing rate of exchange. At the revised parity, we will have required to make up the Fund's holdings to a little under Rs. 225 crores. The extra payment needed is of the order of Rs. 68.66 crores. The extra payment needed in the case of the Bank is Rs. 10.46 crores.

It will be possible to make payment in non-negotiable non-interest bearing securities encashable on demand.

18. By how much approximately does the cost of repayment of the loans so far taken from these two institutions increase as a result of the new parity of the Indian rupee?

18. We have borrowed so far $ 44 millions from the World Bank and $ 100 millions from the International Monetary Fund. If we get a further loan of $ 22 millions to finance the Bokaro Power plant, we will have to pay in all the Bretton Woods Institutions a sum

of $ 15.1 millions per annum as a minimum and $ 18.74 millions per annum as a maximum till the year 1974-75. This is on the assumption that the loan of $ 100 millions from the IMF will be repaid in ten years.

The whole cost of these loans aggregating to $ 34 millions disbursed by the World Bank already will have been increased by Rs. 8.35 crores as a result of devaluation.

19. Will it be possible to stop food imports from the Western Hemisphere as a result of devaluation ?

19. Our imports from the hard currency areas were 1,308,000 tons in 1946-47, 1,585,000 tons in 1947-48 and 632,000 tons in the last three quarters of 1948. We will probably not be able to avoid importing 500,000 tons of wheat, even if the obligation to purchase at the floor prices under the International Wheat Agreement does not materialise.

The cost of purchasing 500,000 tons at 170 cents a bushel, which is the agreed maximum price under the International Wheat Agreement, in the second year will be Rs. 15.11 crores and the cost of freight at Rs. 57.6 per ton, which was the average paid in the last three financial years, will be Rs. 2.88 crores. The total cost will thus be Rs. 18 crores.

20. Has devaluation given Australia the right to raise Wheat prices fixed under the Wheat agreement in Canadian dollars ?

20. The revised International Wheat agreement concluded on the 23rd March '49, and effective from the

1st August '49, stipulated prices in terms of the Canadian dollar as of the value on the 1st of March 1949. We are not, however, obliged to purchase our quota of 38.287 million bushels (60 lbs. each) from Australia unless the quota is being offered at the following prices.

1949-50	$ 1. 50
1950-51	$ 1. 40
1951-52	$ 1. 30
1952-53	$ 1. 20

Even if wheat is forthcoming at these prices, Article X protects us in the event of balance of payments difficulties.

Our contracts with Australia have provided for the following purchases.

1947-48	28.75 million bushels at 18sh. 6d. (A—Rs. 10-10-8)
1948-49	32.50 million bushels at the old or the Wheat agreement prices.

On the 1st of October, 1949 we had commitments to purchase only 218,500 tons of wheat, and we have at present (15-12-49) no firm import programmes except for 390,000 tons of Argentine wheat which are being imported on bilateral terms. This means that as long as there is no settlement of the price of wheat as a result of negotiations, we can plead inability under Article X of the Wheat agreement, in the event of wheat prices touching the floor.

21. Is there a prospect that some dollar expenditure or purchases will be stopped as a result of the devaluation of the Rupee?

21. There is very little prospect, because dollar prices are still competitive. For example, even allowing for devaluation, the cost of dollar wheat is considerably less than the cost of rice. Dollar purchases have already been cut down to the minimum. It has been unofficially estimated that we will forego about $ 20 millions worth of purchases, but this expectation may not materialise.

The ceiling available for dollar imports in the six months ending the 31st December 1949, has been fixed at Rs. 38.5 crores. As a result of devaluation the Government of India has permitted importers to refix ceiling limits in Indian rupees, and since there is very little prospect that the ceiling in a full year for commercial imports will be higher than, say, Rs. 75 to Rs. 80 crores, any relief to private importers can only be at the cost of Government imports in so far as these can be cut down or financed with special aid.

22. Will it be necessary for us to seek external aid in dollars in the immediate future as a result of the present decision?

to the recent

at the Conference of Commonwealth Finance Ministers in England, any dollar imports financed with external credits are outside the ceiling of 75 per cent of the imports, from the dollar areas, fixed for the imports of the members of the sterling area. We will need these

credits in order to remove shortages in our economy, for example, raw cotton. The Export-Import Bank which is the main source of lending at present has uncommitted resources amounting as of the 30th June 1949, to $ 953.4 millions. The World Bank has already advanced $ 44 millions. The World Bank authorities have announced that there will be further lending, possibly of another $ 31 millions.

23. As between maintaining the parity with the sterling area and maintaining the parity with the dollar area, which is to be preferred on a long range view?

23. The current level of British exports—disregarding the months of July and August 1949—may be assumed to be about 150 per cent of the pre-war volume. Before import policy was liberalised in India by the introduction of O.G.L. XI, about 42 per cent of the exports from the United Kingdom destined for India was in the form of machinery. The United Kingdom was thus a considerable supplier of machinery and in some lines, e g. textile machinery, she is still the leader. If British prices and delivery dates become favourable, the link with the sterling area will ultimately become very profitable. In the meantime, in the short-term period, our aim should be to conserve our sterling balances by paying for as much as possible of the imports from the sterling area in current exports. Since it is easier to increase our exports to the sterling area than to the dollar or hard currency areas, it was justifiable, from the long-term point of view, to have moved in step with the

sterling area.

24. What are the indications, if any, that the Pakistan rupee will be undervalued at the new rate of convertibility with the dollar which India has adopted?

24. Neither the purchasing power theory which economists like Cassel supported nor the criteria regarding balance of payments to which Lord Keynes attached much more importance are of relevance in this connection.

These theories are valid if there is a free flow and exchange of goods and services. While foreign trade remains subject to control, any rate of exchange within reasonable limits can be supported by regulating prices and volume. Since the level of austerity for which is prepared cannot be forecast, the rate of cannot be fixed primarily with reference to the price level.

Nevertheless from the random price comparisons made below, it will be seen that there is a case *prima facie* for saying that the Pakistan rupee is overvalued at the new rate.

Cement.	Indian Portland "Swastika," f. o. r. Calcutta, per ton Rs. 82-8-0.	Dalmia at Karachi.
Coal.	Rail-borne trimmed into Bunkers in Docks at Bombay, Rs. 48-12-0.	First class Bengal trimmed into Bunkers, Rs. 90-11-0

	Sea-borne trimmed into Bunkers in Docks, Rs. 80-0-0	
Sugar Refined.	Bara Banki E27, Rs. 35-8-0 per maund; Maholi E28, Rs. 35-4-0 per maund; Hardoi, E28, Rs. 36-4-0 per maund.	Rs. 36-0-0 Rs. 40-0-0 and Rs. 38-12-0 at Karachi, Mardan and Dacca.
Tea.	Sale average for consumption in India 1-6-1 at Calcutta.	Orange Pekoe 2-0-0 Dust High grown 1-11-0.
Wheat.	Hapur Rs. 18-8-0 per maund, Amritsar Rs. 15-5-0 per maund.	Rs. 12-0-10 per maund at Karachi.
Cocoanut Oil.	30-8-0 per 35 lbs. derived from prices per candy of 655.6 lbs. at Cochin.	65 per 35 lbs. at Karachi (IEFC allocation)
Rice.	Wholesale prices per maund payable by retailers to Government at Calcutta; Aus and Coarse Aman, Rs. 15/4, Medium Aman, Rs. 16-8-0. Fine Aman, Rs 25-4-0.	Chittagong Rs. 27-0-0 Dacca Rs. 38-0-0 and Mymensingh Rs. 41-8-0.

25. Will Pakistan be able to balance her foreign trade at the old parity which she has chosen to maintain ?

25. In the first five months of 1949, Pakistan's surplus in her trade with the United States was

$ 741,000. This gives an annual rate of a little over $ 1.78 millions in the trade with the United States, compared with $ 9.19 millions in 1948. Pakistan's trade with the United Kingdom in the first seven months of 1949 indicates a heavy adverse balance of trade. The maintenance of the present value of the rupee would both discourage exports and encourage imports, and widen the overall adverse balance, while largely destroying the surplus in hard currencies. Rigorous import control would be necessary to offset the effects of a decision not to devalue the Pakistan Rupee.

26. How long can the Pakistan rupee maintain the existing rate of convertibility with the dollar?

26. This depends on how rigorous import control is going to be, how long the buyers' resistance can last and how considerable the adverse balance is going. It is, however, possible that the straight release of £ 12 millions by the United Kingdom will prove insufficient to close the trade gap even with the import control which has been introduced since devaluation. It is unlikely in that event that the present exchange rate can be maintained for a long period.

27. What is likely to be her loss in export trade at the present level of her rupee in respect of countries other than India?

27. In the year ended the 30th June 1949, Pakistan imported from countries other than India Rs. 87.57 crores worth of goods. She had an adverse

balance of Rs. 6.20 crores in this trade. Invisibles and the movement of funds have to be added to this gap. More recently the Governor of the State Bank of Pakistan has estimated the adverse balance of payments with countries other than India at Rs. 51.08 crores for the same period. How much this adverse balance will increase cannot be stated, but it is likely that it will increase considerably.

28. How soon and approximately by how much are the prices of Pakistan's exports to India likely to fall at the new rate?

28. The export duty on raw cotton exported from Pakistan is Rs. 60 per bale. As a result of devaluation, this has been reduced for common varieties by Rs. 20. In addition to the ordinary jute export duty an excise duty of Rs. 1-8-0 per bale on cuttings and Rs. 5-0-0 per bale on jute other than cuttings was imposed in the last Pakistan budget. The first impact of buyer's resistance will be felt in the reduction of these duties. But a fall in prices is inevitable, as there is not much demand outside the Indian market for these raw materials. Jute prices will fall sooner and more steeply than cotton prices, and the downward trend has been in evidence for some time.

29. Should exchange control between the two countries now be imposed?

29. There will be no advantage in restricting from our side the flow of funds to and from Pakistan. If anything, the advantage in present circumstances is likely

to be in favour of India, because while there is speculation regarding the future level of the Pakistan rupee, bona-fide remittances to Pakistan will be held over to the extent possible, and there will be a flow of funds to India.

30. Is India in a position to increase the prices of her exports to Pakistan?

30. The estimated value of India's exports to was approximately Rs. 75 crores at the time of the conclusı the last trade and payments agreements. Our export prices can be increased derabl so as to offset the artificial cheapening of these imports into Pakistan, by export duties and export licensing which will make Pakistan prices higher.

31. Having regard to the present positon of the Indian economy can multiple currency practices be permitted; and, if so, what pattern would suit us best?

31. Although the International Monetary Fund is against multiple currency practices, it has permitted them, mostly in the case of the Latin American countries. The general tendencies, however, are not to permit multiple currency practices in the case of countries for which uniform par values have already been recognised, and not to permit discrimination against particular countries. Discrimination for, or against particular goods, has been permitted, but in Indian conditions even

this would be difficult to enforce, and will not be desirable on merits.

32. What are the likely effects on Pakistan's position in the sterling area of her present decision?

32. Pakistan is the only Commonwealth country which has not devalued. At present, she is not a member of the I.M.F. She is running a heavy adverse balance of trade with the United Kingdom and her favourable balance of trade with the U.S. dollar area is disappearing (In the first five months of 1949, the favourable balance of trade with the U. S. was only \$ 7,41,000). Pakistan has been granted sterling releases of £ 17 millions in the year 1949-50 on the condition that she restricts her imports from the dollar areas to \$ 65 millions per annum. The latter figure is based on her trade with the United States in 1948-49, as a special concession to the Pakistan Government.

The Commonwealth Finance Ministers, when they meet in London for the periodical review of the sterling area's position, are entitled to ask for uniformity of treatment of all the sterling area countries in the matter of the fixation of ceiling limits for imports from the dollar areas. This would mean that Pakistan would be restricted to her lower evels of import in 1948. The Commonwealth Finance Ministers will also be entitled to represent that Pakistan's exports being discouraged by the present level of her rupee, while her imports are encouraged and have to be restricted by import controls, there is a fundamental disequilibrium in her economy. The International Monetary Fund is not likely to lend to Pakistan

under the present circumstances. The sterling area with its limited central reserves cannot do what the International Monetary Fund will most probably not undertake to do. The Commonwealth Finance Ministers may press the case that partly in the interests of building up the reserves of the sterling area, and partly as a test case, Pakistan should be compelled to approach the International Monetary Fund.

If this line of argument prevails, Pakistan's position as a member of the sterling area will be considerably weakened.

33. Has Pakistan reduced the value of her debt to India as a result of the present decision?

33. The principles of the Inter-dominion financial agreement, which was concluded in December 1947, have still to be worked out in detail by an Application Committee appointed jointly by both the dominions. At present it has been roughly estimated that Pakistan would owe a sum of Rs. 300 crores to India as a result of the settlement. The first payment is to start on the 15th August 1952. The payments are to taper off from about Rs. 15 crores in the first year and will continue till the 15th August, 2001. Since repayment is to be in fifty equated annual instalments the annual payments will be a little less than Rs. 15

The present measure of devaluation is a limited intended to lower the value of the rupee ex-y in terms of the hard currencies. The burden of the debt which India assumed is not significantly reduced

by devaluation because devaluation has no primary effect on prices. The total sum of approximately Rs. 300 crores is a debt which Pakistan in fact could have assumed directly, were it not for the fact that investors in Government securities cannot be chosen arbitrarily, and asked to become creditors of the one Government or the other. Our interest in this matter at present may be summed up as follows. If the inter-dominion payments are made year by year as they accrue in Indian rupees, there is no loss. But if payment is made in Pakistan rupees while the exchange is fluid or while the convertibility of the Pakistan rupees is restricted, or has to be secured by negotiation, there will be loss to India as a result of devaluation.

The Application Committee will no doubt consider this point in due course.

34. How far is the rise of prices in India due to the import policy adopted towards the end of August, and how far is it due to the depreciation of the value of the Rupee?

34. Open Generel Licence No. XVI for import from other than hard currency areas was issued on t 25th August 1949, and contained only twenty-five categories of items. This was a more important development than devaluation, because under the import licensing policy for the half-year ending the 31st December 1949. which was settled before devaluation, only machinery could be imported freely from the hard currency areas. The effect of restricting these imports in physical quantity

will not be immediately felt upon the price level. We do not depend for raw material on other countries than Pakistan, and in the case of Pakistan the effects of devaluation are likely to be offset. In the result, the rise in prices, to the extent that it occurs will be due to the scarcity of food imports, and to failures in the supply of cotton. Even in respect of these two items, it should be possible to prevent a rise in prices by remedial action.

35. Is there evidence that Indian exports are not selling now because of their high cost?

35. According to statistics compiled by the International Monetary Fund, the price of raw jute in New York in April was 400 dollars per short ton, against 439 in India for export f.o.b. and 432 for export to the United Kingdom c.i f. In 1948, the United St
consumed about 5,00,000 tons of paper for
and this consumption has been steadily
These two facts indicate the vulnerability of one of our principal exports because of the price factor.

36. Do you think that prices can be held at the present level without a decline in the standard of life?

36. This is not possible. Agricultural prices cannot be depressed without a fall in the standard of life of the agriculturist, and industrial prices cannot be depressed without a fall in profits, the stabilisation of wages,

and the retrenchment of surplus labour. The major problem before the country at present is the balance of payments problem. If our export prices are to come down and exports are to be increased in volume, a decline in the standard of life is inevitable. In the longer period, of course, this may be reversed.

37. How has devaluation affected the Indian Budget?

37. Six new categories of export duties counting vegetable oils and vegetable products together can be levied by the Government of India in the terms of an ordinance recently issued. In November, '49, this ordinance was amended to permit a new duty on black pepper and the increase of the duty on raw cotton. This will help considerably in closing the budgetary gap, probably to the extent of Rs. 10 crores. The Government of India's dollar expenditure is negligible, and it has been computed that it will go up in all only by Rs. 6 crores. Their expenditure on food subsidies will be substantially less than the present level of Rs. 32.97 crores, as rice imports have already been stopped because of exchange difficulties, and wheat imports from the hard currency areas will now be stopped.

The direct effect of devaluation on the budget is thus only salutary. But it makes a deflationary budget policy more urgent than before.

38. What is the budgetary policy appropriate to the present time?

38. The budgetary policy appropriate to the present time is a deflationary policy because it is neces-

sary to retain the benefits of devaluation. Such a policy was announced by the Finance Minister in the devaluation debate on the 5th October 1949, embracing the following items:

(i) Formulation of a pattern of trade which would reduce our expenditure of foreign exchange to the minimum, having regard to the essential requirements of the country. Shortly before devaluation, a foreign exchange budget had been adopted, which in essentials was as follows :

(In crores of rupees

Commercial imports	400	Commercial exports and invisibles	490
Food imports	100	Adverse Balance	110
Government imports	100		
Total	600	Total	600

The commitments have now been reduced under this budget:

(ii) employment of our purchasing power for the purpose of bringing down to a reasonable minimum the prices of industrial raw materials imported from countries which have not devalued;

(iii) prevention of speculative prices by legislative and administrative measures and by the regulation of credit facilities . (The Reserve Bank have prescribed and have been examining the

returns of advances by banking companies in excess of Rs. 1 lakh);

(iv) imposition of customs duties, consistently with the principle of non-discrimination on exports to hard currency areas, so that there is an equitable distribution of the advantages of devaluation between the importer, the exporter and the exchequer;

(v) stimulation of investment by compulsory saving and extension of banking facilities;

(vi) voluntary settlement of taxes of assessees whose cases have not been referred to the Income Tax Investigation Commission;

(vii) economy intended to secure Rs. 40 crores in the current year (1949-50) and Rs. 80 crores in 1950-51

(viii) ten per cent reduction of prices of certain essential commodities and of foodgrains.

39. Is a crisis in important Indian industries likely as a result of devaluation?

39. We are already entitled to receive under the bilateral agreement with Egypt concluded in May, 1949 and effective for one year from the 6th July 1949, 300,000 Egyptian bales of raw cotton.

The British Raw Cotton Commission has recently purchased 3 lakhs of bales of East Africa cotton, of which 2 lakhs were intended for India. A delegation to select the varieties making up this quantity and to purchase further quantities of Sudanese cotton has been

able to step up this quantity to 2½ lakhs and to secure a further 50,000 lakhs of Uganda cotton and the possibility of getting cotton from Peru and Brazil has not been excluded. The current American cotton crop is a bumper crop of 15.446 million bales and some part of this may be available in case of an emergency. Government has recently announced that imports up to 1 million lakhs will be pe

It has been announced on behalf of the Government that 10 lakhs of bales of foreign non Pakistan cotton in all will be imported in the current year 15th September, 1950 to the 31st August, 1951, incl the Egyptian and East Africa contracts already

The latest estimated stocks of the cotton textile mills as on 31-8-49 are 12.2 lakhs of bales, the estimated crop varying between optimistic estimates of 35 lakhs of bales and conservative estimates of 28 lakhs of bales. In the jute industry, stocks at the end of October, 1949, were estimated at 9.26 lakhs of bales, and the crop this year is 27 lakhs of bales. In view of this stock position a crisis in either industry can be

With effect from 5-12-49 the jute industry is now working 42½ hours a week.

40. Can India benefit from raising the value of the Rupee now by, say, ten per cent ?

40. It is not advisable to take advantage at present of the provision in the Articles of

Agreement of the International Monetary Fund which permits us to vary the par value within ten per cent. In the first place, the ten per cent, being calculated on the new parity of 21 cents per rupee, does not carry us very far. In the second place, while prices are still high, and export duties at high rates have been levied or are likely to be levied, any step which would put up prices should be avoided. Later on, there may be a case for an upward revision, but the rupee is likely to have worked up to a higher parity by that time, and it may be possible again to move in step.